Sections of the Cable Television and Consumer Protection Act of 1992--Rate Regulation, Second Order on Reconsideration, MM-Docket No. 92-266 (adopted and released, March 30, 1994), the Commission primarily relied on information submitted by the 46 overbuild systems it had surveyed and what it perceived to be a well-recognized phenomenon of economic theory--duopoly collusive pricing. See id. at ¶ 30. 24/

The Commission had no evidence to conclude duopoly overbuild situations resulted in the collusive pricing phenomenon described in the Second Order on Reconsideration. To the contrary, the evidence has shown the existence of price wars between the initially franchised cable operator and the overbuilder. Indeed, low prices (TWC says unrealistically and uneconomically low) rather than high prices are typical of overbuilds in the short run and the reason overbuilds are included in the "competitive model". Surely, the Commission cannot have it both ways.

Moreover, it is price wars that are consistent with the well-accepted conclusion that overbuild systems are

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24/ TWC believes that many aspects of the Commission's rate regulation Orders (including the revision of the competitive differential) constitute arbitrary and capricious agency behavior, exceed the Commission's statutory authority and are contrary to constitutional right. For such reasons, TWC has petitioned the D.C. Circuit for review of these Orders. These comments are submitted without prejudice to any arguments or positions TWC will assert in those proceedings.

not viable in the long-run. See, e.g., Malarkey-Taylor Associates, Economic Analysis of Cable System Overbuilds i-ii (1987) (concluding that overbuilds are "impractical" and emphasizing their negative profitability); H.R. Rep. No. 628, 102d Cong., 2d Sess. 45 (1992) (recognizing "that competitive entry [by overbuilds] frequently results in the survival of a single firm"). Typically, overbuilders have sold their system to the incumbent cable operator after only a few years of service and after having overbuilt only selected areas of the incumbent operator's franchise. See H. Rep. 45 (discussing prevalence of "greenmail" practices by overbuilders); Id. (discussing frequency of "greenmail" sales even before overbuilder constructs system). For those overbuilds that have endured for a longer period of time, 25/ the Commission has concluded that their pricing data does not accurately reflect competition based on its

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25/ The fact that an overbuilder has not exited in its early years does not necessarily mean that it is profitable. It might be related to government regulators prohibiting a sale of a cable system to the incumbent cable operator or to a lack of interest by any third-party purchaser. Indeed, the 1992 Cable Act discourages just such transfers. 47 U.S.C. § 537(a) (cable operators generally prohibited from selling a cable system "within a 36-month period following either the acquisition of initial construction of such system").

perception of collusive pricing. As discussed above, that is simply incorrect. 26/

B. Competition to cable from MVPDs will become even more vigorous in the immediate future.

The significant competition to cable presently provided by MVPDs will become even more vigorous in the near future. Perhaps unlike their forerunners in the various MVPD technologies who confronted financial or organizational difficulties (e.g., Microband and Sky Pix), many MVPDs today are well-financed and well-planned business ventures. Examples are rather obvious. The LECs, for instance, are corporations with revenues and cash flow that significantly outsize those of any multiple system operator in the cable industry. See Michael Krantz, Whose Highway Is It? Regional Bells Holding Companies Look Into Cable Television and the Information Highway, Mediaweek, April 11, 1994 (noting that "for members of the media business, LECs' revenues and cash-on-hand make yours look like lunch money")

26/ The Commission asks in one brief passage whether municipal overbuilds entail different considerations from private overbuilds. Undoubtedly, that question must be answered in the affirmative. For one thing, municipal overbuilds lack the profit maximizing incentives that characterize private cable systems; any losses are funded by the taxpayers. Rates thus can be set at artificially low prices. For another thing, the municipal system is free of a franchise fee and, at least from the subscriber's perspective, would appear to be less expensive on an order of about 5 percent, all other costs being equal.

(available on Nexis); Andrew Kupfer, The Baby Bells Butt Heads, Fortune, March 21, 1994, at 76 ("[w]ith their huge cash flows and their monopoly hold on the seven regions into which the U.S. was carved when AT&T shed its local phone systems ten years ago, the Baby Bells have emerged as powerful contenders in the race to network the nation"). A similar description could be attached to the present DBS participants. DirecTV, for example, is a subsidiary of Hughes Communications Inc., which is itself a subsidiary of General Motors, the largest industrial corporation in the world. Even some of the MMDS participants are well-capitalized and have issued public offerings greeted with much fan-fare on Wall Street. 27/

C. Some Commission policies have aided MVPDs ability to compete against cable operators.

To some extent, the success of MVPDs' ability to compete with cable operators has been aided by policies and rules adopted by the Commission, which have hindered the

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27/ For example, CableMaxx Inc., a wireless operator in San Antonio, completed a public offering in November 1993, that netted over $38 million; People's Choice TV, a wireless operator in several major cities, made an initial offering of 2.875 million shares at a price of $10.50 and followed that in January, 1994, with an offering of an additional 1.25 million shares at a price of $29; and, Heartland Wireless Communications, Inc., recently raised $22 million in a public offering in April, 1994. See also supra n.20 (noting that over $400 million flowed into the wireless industry in 1993).

cable industry's ability to compete. One example is the Commission's recent interpretation of the uniform rates provision of the 1992 Cable Act, 47 U.S.C. § 543(d). On March 30, 1994, the Commission released its Third Order on Reconsideration in rate regulation, In re Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992-- Rate Regulation, Third Order on Reconsideration, MM-Docket No. 92-266 (adopted and released, March 30, 1994), in which the Commission reads § 543(d) to mean that a cable operator must have a uniform rate structure within each franchise area, including those areas where effective competition exists. Id. at ¶ 18. Further, the Commission concludes that this provision prohibits cable operators from negotiating rates for multiple dwelling units ("MDUs"), or from offering non-predatory bulk account discounts. Id. at ¶ 20.

By reading this rule so, the Commission has greatly hindered cable operators' ability to compete with SMATV systems. In contrast to a cable operator that serves an entire franchise area, including any MDUs located therein, SMATVs typically serve on a building-by-building basis and price differentiate based on a particular building's characteristics. Lacking the price flexibility that characterizes their competitors, cable systems cannot

match SMATVs' pricing and, in TWC's experience, there has been a loss of some MDU accounts to SMATV systems. Thus, competition for MDUs between cable systems and SMATVs is not at all on an equal footing. 28/

The Commission's previous interpretation of what constitutes a "cable system" only exacerbates the competitive imbalance between SMATV systems and cable systems. See In re Definition of a Cable Television System, 5 F.C.C. Rcd. 7638, 7639-40 (1990) ("Cable Definition Order"). In the 1984 Cable Act, Congress established the so-called private cable exception, which excepts from the definition of a cable system "a facility that serves only subscribers in one or more multiple unit dwellings under common ownership, control, or management, unless such facility or facilities uses any public right-of-way". 47 U.S.C. § 522(7), as amended.

The Commission has interpreted this provision to mean that SMATV systems connecting buildings by microwave or other "wireless means" are not cable systems, whether or not the connected building are commonly owned. See Cable Definition Order, 5 F.C.C. Rcd. at 7641. This type of SMATV system is thus exempt from any franchising requirement. See

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28/ Moreover, by restraining the cable operator's ability to meet competition from SMATV systems, this policy plainly disadvantages the consumer.

47 U.S.C. § 541(b) (any "cable operator" must obtain franchise). 29/ The Commission reached this conclusion, because it believed that such systems are not a "set of closed transmission paths", the language used by Congress in defining a cable system. See Cable Definition Order, 5 F.C.C. Rcd. at 7638-39.

TWC believes this interpretation should be revisited and amended. First, cable operators often use microwave relays to connect physically remote portions of their systems to a head-end. However, in contrast to its SMATV rule, the Commission has indicated that such parts of a cable system are still part of the "system". 30/ But, there is no reason why a SMATV operator serving more than one building (connected by radio or microwave relay) should be considered any less of a "system" than this hypothetical cable system. Second, Congress has not defined the term "closed transmission path", much less given any indication

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29/ In FCC v. Beach Communications, Inc., 113 S. Ct. 2096, 2103-04 (1993), the Supreme Court upheld the part of the Commission's cable system definition that considered any SMATV system interconnecting separately owned, managed or controlled building, whether or not public rights-of-way were used, to be a cable system.

30/ See Cable Definition Order, 5 F.C.C. Rcd. at 7644 n.12 ("[u]se of such radio facilities clearly does not remove what is otherwise a cable system from the coverage of the definition because the connected parts of such facilities would be independently covered by the definition").

that it meant to do so in such a fashion as to exclude microwave or radio transmission. Third, there is no reason to consider transmission via microwave to be any more "closed" than transmission by other paths. 31/ Fourth, the one court to consider this issue, as noted by the Commission in the Cable Definition Order, has reached a contrary result. See City of Fargo v. Prime Time Entertainment, Inc., No. A3-87-47 (D.N.D. March 28, 1988) (unpublished) (SMATV system with infrared relay between buildings not commonly owned is a "cable system"). Fifth, the Commission's present rule has the rather ironic (and we suggest unintended) result of treating larger SMATV systems more favorably than smaller, because SMATV systems linked by radio or microwave would be expected to serve more subscribers than those linked by hard-wire. 32/ Thus, this

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31/ In the Order, the Commission relied to some extent on language in the Senate Report to the 1984 Act, which refers to "closed transmission media" and uses examples of physically shielded media (cable and fiber). However, general industry practice is to refer to "closed" transmissions (e.g., "closed circuit") in the sense of transmission to discrete locations by means of satellite, microwave or cable, which would accurately describe SMATV microwave relays between buildings. Moreover, Congress ultimately selected the word "path", not "media", the word discussed in the Senate Report.

32/ It is not possible to explain the exempting of radio or microwave SMATV systems from the definition of cable system on the ground that these modes of transmission do not occupy public rights-of-way. In upholding the Commission's rule that considers SMATV systems serving

SMATV policy represents a situation in which the Commission, on the one hand, has provided a favorable regulatory climate for a non-cable MVPD, and, on the other, simultaneously hampered cable's ability to compete with that MVPD.

III. THE COMMISSION HAS WRONGLY PRESUPPOSED THE EXISTENCE OF ANTICOMPETITIVE BEHAVIOR BY VERTICALLY INTEGRATED OPERATORS AND PROGRAMMERS AND THEREBY IGNORES THE BENEFITS THAT RESULT FROM VERTICAL INTEGRATION.

The NOI seeks comment upon a broad range of issues concerning vertical and horizontal integration in the cable industry, particularly issues related to the cable industry's behavior since the 1992 Cable Act and the Commission's regulations implementing various sections of the Act were adopted. As part of that inquiry, it is evident that the Commission presupposes the existence of anticompetitive behavior, particularly by those members of the cable industry that are vertically integrated. See NOI, ¶ 72 (seeking comments regarding "whether anticompetitive practices in the multichannel video programming and distribution markets have diminished"); id. at ¶ 73 ("we

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separately owned buildings to be cable systems whether or not public rights-of-way are used, the Supreme Court made clear in Beach that the public rights-of-way question is not dispositive of whether a SMATV is a cable system. Quite the contrary, SMATV systems that do not use rights-of-way may well be deemed cable systems.

intend to examine whether the anticompetitive conduct . . . continues").

TWC believes that presumption to be utterly baseless. There is no evidence that the industry as a whole has engaged in anticompetitive behavior or that the members of the industry generally have disregarded any of the Commission's regulations implementing vertical and horizontal behavioral restrictions. Should any commenter propose otherwise, TWC will respond, as necessary, at the reply comment stage.

The Commission's inquiry, however, does give rise to a more serious concern. By inviting comments based upon a veritable presumption that generally there has been anticompetitive behavior, particularly from vertically integrated cable industry members, the Commission appears to disregard entirely the notable and numerous pro-competitive benefits vertical integration has fostered, and which the Commission should take into account. See, e.g., 47 U.S.C. § 533(f)(2)(C)-(G). Although the Commission does solicit limited inquiry about whether its regulations may unduly have restricted the beneficial effects associated with vertical integration, TWC believes the Commission's fundamental approach in the NOI--focusing as it does on purported negative effects of vertically integration--will

greatly understate its benefits. To address that concern, we briefly touch upon those benefits here.

A. Vertical integration has generally been recognized to confer pro-competitive effects.

As a general matter, vertical integration makes sound economic sense. It has been widely recognized by numerous scholars that a business firm achieves many efficiencies by becoming vertically integrated. See, e.g., 3 Phillip E. Areeda & Donald F. Turner, Antitrust Law: An Analysis of Antitrust Principles and Their Application, 724-25 (1978) (arguing that prohibitions against vertical integration should be the exception rather than the rule because vertical integration can create two types of efficiency gains--production economies resulting from technological interdependencies and market transaction cost savings); F.M. Scherer, Industrial Market Structure and Economic Performance 87 (1970) (proposing that vertical integration creates savings in market transaction costs).

Similarly, the courts generally have not treated vertical integration as a threat to competition; rather, decisions looking at the behavior of vertically integrated firms often have acknowledged the pro-competitive effects of their integration. See United States v. Columbia Steel Co., 334 U.S. 495, 525 (1948) (vertical integration in itself does not violate Sherman Act); Jack Walters & Sons Corp. v.

Morton Bldg., Inc., 737 F.2d 698, 710 (7th Cir.) ("[v]ertical integration is a universal feature of economic life and it would be absurd to make it a suspect category under the antitrust laws"), cert. denied, 469 U.S. 1018 (1984). 33/

B. Vertical integration has been a driving force for the cable industry's growth and achievement.

Within the cable industry, vertical integration between cable operators and programming services indisputably has been a benefit both to the cable industry and to cable subscribers. There can be little doubt that the abundance of diverse programming available to subscribers today reflects the beneficial effects of vertical integration. On a number of occasions, for example, cable operators accepted the attendant risks and invested in programming services beset by financial crisis. 34/ Moreover, investments by cable systems have

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33/ See also Auburn News Co., Inc. v. Providence Journal Co., 659 F.2d 273, 278 (1st Cir. 1981) ("vertical integration can result in savings in market transaction costs and production economies. New efficiencies and innovations may ultimately yield lower prices on the end product. Integration can thus be a good faith effort to do business in more efficient ways."); Byars v. Bluff City News Co., Inc., 609 F.2d 843, 861 (6th Cir. 1979) ("substitution of a more efficient distributor . . . would ordinarily enhance competition in the distribution market").

34/ For example, in 1986, when Turner Broadcasting System (now CNN, TBS-superstation, TNT and the Cartoon Network) encountered financial difficulty, a number of MSOs

promoted the development of a variety of new and diverse programming services, including: C-Span; Black Entertainment Television ("BET"); QVC; Comedy Central; Courtroom Television Network; E! Entertainment Television. 35/

In the 1990 Report, the Commission recognized the benefits of vertical integration and conceded that "vertical integration produces significant benefits for cable subscribers". 1990 Report, 5 F.C.C. Rcd. at 5008. That conclusion echoes findings from a more comprehensive study undertaken in 1988 by the National Telecommunications and Information Administration. See United States Department of Commerce, Video Program Distribution and Cable Television: Current Policy Issues and Recommendations, NTIA Report 88-233 90 (1988) ("NTIA Report"). The NTIA Report found that "[c]ommon ownership of a cable system and a cable program

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invested capital. Similarly, the Chairman of the Discovery Channel, John S. Hendricks, has testified before Congress that investment by cable operators "rescue[d]" his programming service. 1990 Report, 5 F.C.C. Rcd. at 5009 (quoting statement of John S. Hendricks before the Subcommittee on Communications of the Senate Committee on Commerce, Science and Transportation).

35/ Various cable operators' financial backing has been acknowledged by BET as being "most responsible for the fact that black Americans today have dedicated to their specific viewing interest a 24-hour cable television network". 1990 Report, 5 F.C.C. Rcd. at 1009 (quoting testimony of Robert L. Johnson before the Subcommittee on Communications of the Senate Committee on Commerce, Science and Transportation).

service may produce significant benefits for the integrated firm and its customers". Id.

These conclusions result from the simple fact that cable operators are well-situated to maximize the efficiencies to be gained through investment in programming. As the Commission has noted, vertical integration "can help a cable company avoid transaction costs normally incurred in acquiring programming". 1990 Report, 5 F.C.C. Rcd. at 5009; see also 1988 NTIA Report at 90 ("[t]he principle benefit is that vertical integration allows the cable firm to avoid the transaction costs of obtaining programming"). The expenses saved in time, human resources, and negotiating and enforcing program contracts may be passed on as savings to the cable consumer. In turn, the support of the cable operator aids the start-up programmer by providing needed capital and ensuring a guaranteed subscriber base. See 1990 Report, 5 F.C.C. Rcd. at 5009. 36/

36/ It has often been true that only cable operators have been willing to make the substantial and risky investments necessary to produce new programming. A good example, of course, is when Manhattan Cable Television, a TWC cable system, developed and launched HBO during the early 1970's to attract subscribers to cable. Recent programming ventures have required large expenditures before achieving profitability. However, "[b]y underwriting some of the costs of a new program service, a cable operator can spread some of those risks among several firms, thereby increasing the probability that the service will make it to the marketplace". NTIA Report at 91.

The obvious incentives for cable operators to invest in and cultivate the development of new and diverse programming services--that is, to assure the existence of quality programming that will attract subscribers and thereby increase revenues--have been chilled unduly by the Commission's regulations implementing various sections of the 1992 Cable Act. 37/ In particular, the rule promulgated by the Commission establishing a 40% limit on the number of channels that can be occupied by a vertically integrated programmer on affiliated cable systems plainly acts as a disincentive to the creation of video programming by vertically integrated members of the cable industry.

In the NOI, the Commission also regards channel occupancy limits as an appropriate means "to promote diversity". NOI, ¶ 57. Yet, the Commission previously has recognized that investment by cable operators "produce[d] significant benefits for cable subscribers" in the form of "more original programming" and "program diversity". 1990 Report, 5 F.C.C. Rcd. at 5008-09. Indeed, the proliferation in the "quality and quantity of program services available to the viewing public" previously cited by the Commission,

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37/ For example, a number of proposed programming services have delayed their launch. See Kim Mitchell and Rod Grander, Operators Give New Networks Little Attention, Multichannel News, March 7, 1994, at 3 (listing networks).

id. at 5007, seems certain to be thwarted in light of the shackles now placed upon cable operators' incentive to launch vertically integrated programming services.

The Commission's rules thus seem to minimize or pay lip service to the benefits the cable industry has realized from vertical integration. To acknowledge that benefit and have its rules so reflect does not mean that the Commission must forfeit its concerns that cable operators' size or vertical integration might "impede" or "restrict" the "flow of video programming" from programmers to consumers. See 47 U.S.C. § 533(f)(2)(A). Rather, it merely would remove any unnecessary constraint upon a cable operator's incentive to develop new and diverse programming.

IV. THE PROCEDURES FOR COLLECTING DATA FOR FUTURE REPORTS TO CONGRESS SHOULD MINIMIZE THE BURDENS UPON THE CABLE INDUSTRY.

The Commission asks what procedures might be appropriate for it to institute for the gathering of information on a going forward basis for preparing its annual competitive reports to Congress. NOI, ¶¶ 78-79. Although TWC makes no specific suggestion here, it does believe the Commission should focus on two issues in considering this issue.

First, the Commission's rules should be designed to minimize the burdens placed upon the cable industry. With the extensive regulatory efforts prompted by the 1992 Cable Act, this industry has already been overtaxed by the need to participate in numerous rulemakings; to respond to comprehensive Commission surveys and inquiries; and, to implement in its business operations an extremely complex web of regulations, covering diverse areas such as rate regulation (including benchmarks and cost-of-service), must-carry, program-access, horizontal and vertical limitations, and cable equipment compatibility. Some of these rulemakings remain subject to further revision and adjustment. The process thus has already consumed significant time and resources both for the industry and the Commission.

Second, the competition-related information that would be the subject of collection by the Commission constitutes highly confidential and proprietary business information. When considering methods of gathering information, the Commission therefore must assess whether it can adequately assure that no sensitive business information would be disclosed or otherwise available to third-parties. To the extent the Commission cannot assure that the confidential nature of such information can be safeguarded

by any information collecting method, the method should be rejected. 38/

38/ The Commission also requests comment on instituting an anonymous program-access reporting procedure to be followed by Commission investigation of the allegations. NOI, ¶ 88. The Commission suggests this kind of process might provide it with additional information about the conduct of vertically integrated members of the cable industry under the 1992 Cable Act and its implementing regulations. Id. This suggestion should be rejected. First, it presupposes that more (and presumably meritorious) program-access complaints would be filed if the complaint procedure were anonymous. But there is simply no basis for that supposition. If an MVPD had a meritorious claim, there is no reason why it would not be filed. Second, the Commission's proposal would supplant the detailed program access complaint process it has established in the § 19 rulemaking, but there has been no showing that this process is inadequate. Third, to allow anonymous complaints like the Commission suggests would give rise to due process issues from the perspective of the programmer or cable operator alleged to have acted wrongly. Fourth the anonymous procedure could easily become nothing more than an instrument for abject harassment.

Conclusion

TWC advocates that the Commission adopt an approach for its report to Congress that will not understate competition related to the delivery of video programming. The state of competition, significant now, promises to become even more vigorous in the near future.

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Respectfully submitted,

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